BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Low Volume Long Distance Users	)	CC Docket No. 99-249
	)	
Federal-State Joint Board On Universal Service	)	CC Docket No. 96-45

COMMENTS OF TEXAS OFFICE OF PUBLIC UTILITY COUNSEL CONSUMER FEDERATION OF AMERICA CONSUMERS UNION (JOINT CONSUMER COMMENTORS)

Laurie Pappas
Deputy Public Counsel
Texas Office of Public Utility Counsel
1701 N. Congress Avenue, Suite 9-180
Austin, TX 78701
(512) 936-7500 / (512) 936-7520 FAX
Texas State Bar No. 12128690

Mark Cooper
Director of Research
Consumer Federation of America
504 Highgate Terrace
Silver Spring, MD 20904
(301) 384-2204 / (301) 236-0519 FAX

Gene Kimmelman
Co-Director
Consumers Union (Washington, D.C.)
1666 Connecticut Avenue, N.W.
Washington, D.C. 20009
(202) 462-6262 / (202) 265-9548 FAX

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EXECUTIVE SUMMARY

THE CONSUMER IMPACT OF BOTTOM OF THE BILL CHARGES

In January of 1996, just before the Telecommunications Act of 1996 was passed, residential consumers paid a Federal charge (called the Subscriber Line Charge) of $3.50 per line. Its purpose is to help recover the fixed costs of the telephone network that are used by long distance companies (Interexchange Carriers or IXCs) to provide service.

By January 2000, the recovery of costs had been radically changed by a combination of Federal Communications Commission policy and industry pricing practices.

- The subscriber line charge had been joined by another fixed charge at the bottom of the bill called a Primary Interexchange Carrier Charge (PICC). This charge of $1.50 constituted the first increase in federal fixed charges on the bottom of the bill in over a decade.

- Moreover, the subscriber line charge, which had been uniform in the residential sector, was sharply increased for residential second lines. Instead of paying $3.50, customers of residential second lines are now charged $6.07. This increase of $2.57 was in addition to the PICC.

- As a result of these increases, the average consumer is paying about $2.00 per month more in fixed federal charges. In total, this increase has already cost consumers about $2.50 billion per year.

This dramatic increase in fixed charges and cost recovery from low and average volume residential customers took place in spite of the fact that the cost of providing service was declining dramatically. It took place in spite of the fact that the LECs consistently earned excess profits on the costs they were recovering in the federal jurisdiction.

AN IMMEDIATE AND PERMANENT REDUCTION IN COST RECOVERY IS JUSTIFIED ON THE BASIS OF THE RECORD

The economic evidence before the Commission shows that the current recovery of costs is excessive.

- If the Commission implements its decision to utilize forward-looking economic costs (as embodied in the Synthesis Proxy Cost Model) and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased but decreased.

- The Commission has required that the rates for unbundled network elements (UNEs) be set on the basis of forward looking economic costs. Examining the

outcome of the application of that principle at the state level reinforces our conclusion that there is an over recovery of costs in the Federal jurisdiction.

- The conclusion that current cost recovery in the Federal jurisdiction is excessive is also supported by the results of ongoing proceedings at the Commission. Year-after-year, when the local exchange companies report their earnings in the Federal jurisdiction, they are far above the targeted level.

As demonstrated in several proceedings at the FCC, this over-recovery arises because the Commission has not established sufficient productivity goals or held the local company books up to rigorous scrutiny. Excess profits alone account for the $2.5 billion of increased costs imposed on consumers

There is no justifiable basis for delaying the appropriate costing and pricing of the loop. The economic analysis already demonstrates that there is an over-recovery of loop costs by the LECs. The Commission has a duty to consumers to ensure that cost recovery is just and reasonable. Perpetuation of a system that results in over-recovery and cost-shifting violates this duty to customers. We urge the Commission to write an Order that allows for fair recovery of loop costs while allowing cost-justified savings to flow through to customers.

THE THRUST OF THE CALLS PROPOSALS

Against this background of dramatic increases in bills and continuous over-earnings by the LECs, a coalition of the largest local and long distance telephone companies (CALLS) proposed to not only institutionalize these bottom of the bill charges, but to increase them and to increase the total cost recovery in the federal jurisdiction by almost $4 billion. The IXCs went along because they would receive yet another $2 billion reduction in their costs, with no mechanism for ensuring whether, or how, these costs would be passed through to the public.

Consumer groups, small telephone companies, and many state Commissions responded negatively to this proposal, to say the least. Over the past five months, the FCC has sought to reconcile the difference between the CALLS group and consumer groups. No such reconciliation was possible. What has emerged is the offer of a one-sided truce in a long war with a date certain for resumption of hostilities.

- The CALLS proposal now on the table would almost double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about $1.25 per month.

- In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers.

- The proposal would also eliminate the Carrier Common Line Charge (CCL).

- It would institutionalize new and unsubstantiated universal service fund payments as a line item on the bottom of the bill.

- The proposal would reconcile a huge discrepancy between the Wall Street books of the local companies and their regulated books. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal simply wipes the slate clean.

The modified CALLS proposal does not eliminate the philosophical or legal infirmities of the CALLS plan, or address the fact that current cost recovery in the Federal jurisdiction is too high. However if the Commission designs the cost proceeding properly, it at least gives consumers a fighting chance at a date certain in the future, of preventing further unjustified price increases and creates the opportunity to challenge the unfair price increases consumers have experienced since 1996.

CALLS DOES NOT RESOLVE ANY OF THE OUTSTANDING ISSUES

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and transformation of, the universal service fund into a line item are illegal, arbitrary and capricious, uneconomic and unfair.

The Commission has required the states to use forward looking economic costs to set their rates for unbundled network elements and recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet the CALLS proposal does not set recovery of loop costs at forward looking economic levels. It is arbitrary and capricious to lower switching costs to reflect forward looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996.

The CALLS proposals contemplate the deaveraging of rates for the new combined SLC/PICC. The Commission has not discussed to what extent differential SLCs are in conflict with the requirement that rates be reasonably comparable between rural and urban areas. Deaveraged rates must be found to be reasonably comparable.

RECONCILING REGULATORY AND FINANCIAL BOOKS

The LECs propose to amortize the difference between the asset accounts on their regulatory books and the asset accounts on their financial books. The LECs commit to not seeking rate increases as a result of the charges against income that they will take over a five year period. We believe that there is no legitimate claim to recovery of these costs, which have long been written off of their financial books. In our view, the excessive rate of return earned by the LECs has more than compensated them for the occasional write-off of assets that all companies take. We have consistently argued this in the earlier rounds of the docketed proceeding. We believe that consumer should be given rate reductions as a result of the reconciliation of these books and that is precisely what we intend to argue in the rate proceeding that must inevitably take place after the CALLS plan expires.

In the mean time, it is critical for the Commission to ensure that the bizarre treatment of these costs have no impact on access charges, UNE rates or USF distribution.

PROMISES ABOUT PRICE REDUCTIONS LINKED TO THE CALLS PROPOSAL

The FCC has also been given a series of promises dealing with costs and pricing policies that are not part of the current proceeding and are not enforceable by the FCC. AT&T has agreed to eliminate its minimum usage charges – although these charges never involved costs that the FCC regulated and were not subject to FCC price regulation. AT&T has also promised to change its practice of collecting the universal service charge on a per line basis and begin collecting it as a percentage of the bill. Both of these changes are good for consumers, but in no manner should they be considered a *quid pro quo* for access charge reform.

While AT&T claims to link changes in corporate pricing policies that were solely at its discretion to a reduction in its regulated cost of business, these policy changes also reflect negative consumer reaction, Bell Company offers not to charge a monthly fee, and extremely bad publicity. Thus, these "offers" by the some IXCs are merely the recognition by these entities of practices that are no longer sustainable in a competitive marketplace. In addition, the IC pledge to flow through access charge reductions to business and residential customers "over the life of the plan" could be meaningless unless the Commission devises a monitoring mechanism and makes "flow-though" mandatory on a proportion of usage/revenue basis. We believe that any promise worthy of consideration as public policy must carry the same accountability and enforceability as Commission regulatory decisions.

I. INTRODUCTION

A. JOINT COMMENTORS

The Texas Office of Public Utility Counsel (Texas OPC) is the state consumer agency designated by law to represent residential and small business consumer interests of Texas. The agency represents over 8 million residential customers and advocates consumer interests before Texas and Federal regulatory agencies as well as State and Federal courts.

The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the Congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumer's Union's income is solely derived from sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

B. THE CALLS COALITION PROPOSALS ARE NOT THE BASIS FOR A COMPREHENSIVE SETTLEMENT

These three organizations (hereafter, Joint Consumer Commentors) have participated in each of the dockets cited in the caption to this Notice of Proposed Rulemaking.[1] The notice is in response to the modified proposal from a coalition (Coalition for Affordable Local and Long Distance Service, "CALLS") made up entirely of telecommunications companies. The CALLS proposal would radically alter the Commission's approach to access charges and harm the majority of residential consumers.[2]

Previously, CALLS filed its original proposal which was thoroughly discredited in a earlier round of comments. It has now subsequently filed a memorandum and attachments detailing modifications to its original proposal (hereafter CALLSII).[3] CALLSII had such obvious shortcomings that it has been followed by yet further modifications (CALLS III).[4] The filing asserts that the modified proposal represents a comprehensive settlement and that, because it is

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[1] Federal Communications Commission, Notice of Proposed Rulemaking, Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for local Exchange Carriers, CC Docket No. 94-1, Low Volume Long Distance Users, CC Docket No. 99-249 In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 (September 15, 1999).

[2] *Universal Service and Access Reform Proposal*, Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself as the Proposal. We refer to the justification offered as CALLS.

[3] The second proposal is composed of a series of documents and *ex parte* filings including the following, Memorandum in Support of the Revised Plan of The Coalition for Affordable Local and Long Distance Service ("CALLS"), (hereafter CALLSII Memorandum); Modified Universal Service and Access Reform Proposal (Hereafter Modified Proposal); (*Ex parte* of LECs) (*Ex parte* of AT&T), and (*Ex parte* of Sprint) *In the Matter of Price Cap Performance Review of Local Exchange Carriers, Federal and State Joint Board on Universal Service, Low-Volume Long Distance Users, Access Charge Reform,* CC Docket Nos. 94-1, 96-45, 99-249, 96-262, March 8, 2000.

[4] *Ex Parte of Kathy Wallman*, March 29, 2000; *Ex Parte of AT&T*, March 30, 2000.

a settlement, should be accepted by the courts.[5] Nothing could be farther from the truth.

A broad range of consumer groups has participated in each of the proceedings captioned in this Docket throughout their history as well as in the most recent round of comments. A number of these groups jointly made specific and concrete proposals to settle all of the outstanding issues immediately (see Attachment 1). The other parties to this proceeding never discussed or addressed this comprehensive settlement offer with the consumer groups who made it. Their modified filing clearly rejects the comprehensive consumer settlement offer. Instead, they have filed a modified proposal of their own which violates all of the principles that the consumer groups articulated in their proposal.

The CALLS proposal would almost double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about $1.25 per month. In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers. The proposal would also eliminate the Carrier Common Line Charge (CCL). It would institutionalize new and unsubstantiated universal service fund payments as a line item on the bottom of the bill.

The proposal would reconcile a huge discrepancy between the Wall Street books of the local companies and their regulated books. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal simply wipes the slate clean.

[5] CALLSII, p. 10.

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and transformation of, the universal service fund into a line item are illegal, arbitrary and capricious, uneconomic and unfair.

- The Commission has required the states to use forward looking economic costs to set their rates for unbundled network elements and recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet, the CALLS proposal does not set recovery of loop costs at forward looking economic levels. In fact, it increases rates even farther above the forward looking economic levels as determined by the very same model used to estimate switching costs and high cost loop costs. It is arbitrary and capricious to lower switching costs to reflect forward looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

- The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

- The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996.

The proposal would institutionalize federal charges for access that are far in excess of the economic cost of providing access as estimated by the Commission's own forward looking cost model and thereby insulate the charges from competitive pressures. The CALLS proposal insulates other charges from competitive pressures. Although CALLS defenders claim that the proposal is pro-competitive, because it lowers the per minute costs of usage, joint consumer commentors believe it will have the opposite effect because its main thrust is to shift costs out of the most competitive rate elements and into the least competitive area. As a result, a huge set of costs will be shielded from competitive market forces. It is noteworthy that several commentors point out

that one way to expose costs to greater competitive pressures is to remove them from the bill as governmentally mandated line items. This would throw them into the market.

Loop plant is a cost of doing business for telecommunications companies. It is no different than any other cost of doing business. It is illogical for the Commission to continue to allow an antiquated and anti-competitive method of cost recovery for loop plant based on a now defunct notion of monopoly regulation. Congress has ordered the FCC to implement pro-competitive policies and encourage competition. Segregation of certain costs into non-bypassable surcharges inappropriately insulates these costs from competitive pressures thereby defeating the objectives of the Telecommunications Act of 1996. If there ever was a reasonable rationale for these charges, it has certainly gone the way of switchboard operators and party line service. The FCC must stand down and allow carriers to compete for customers on the basis of price, without manipulating cost recovery in a manner contrary to or insulated from market forces.

The conclusion we draw from the legal, conceptual and empirical analysis is straightforward – the CALLS proposal should be rejected. Economic analysis demonstrates that the subscriber line charge is too high; public policy dictates that it should be reduced. In a world of efficient, multi-product telecommunications companies, claims that current fixed charges do not cover the federal share of loop costs are contradicted by the FCC's own cost analysis. Increases in unavoidable end-user charges, mandated by FCC action and tolerated by FCC inaction, run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs.

CALLS II is not the basis for a comprehensive settlement. It resolves some issues partially; delays final consideration of many others; and actually raises a number of new concerns.

CALLS II makes much more progress on issues that were not being litigated in these dockets than it does on issues properly before the Commission. The ultimate day of reckoning on many critical issues has simply been delayed. Therefore, the Commission must be diligent in writing an order that preserves the fundamental principles that consumers have shown are embodied in the Telecommunications Act of 1996.

The Commission has recognized the importance of a number of critical issues to consumers and the CALLS members now at least accept the fact that these principles are important to consumers, albeit without accepting the principles themselves. First and foremost, the Commission should ensure that loop charges are based on economically valid loop costs. In particular, the Commission must guarantee that the "interim cost review" contemplated by CALLS II is based on forward looking costs for all loops; that subscriber line charges for all residential lines are adjusted to reflect the forward looking costs (consistent with the CALLS II caps) as determined in this cost review; and that any reductions in subscriber line charges, or increases in SLCs that are lower than the caps contemplated in CALLS II, would not result a shifting of the "shortfalls" below the CALLS II caps into any other ratepayer charges. In addition, we believe the cost review should include a reassessment, based on the forward looking costs identified in that study, of the need for the $650 million universal service fund for local exchange carriers in the CALLS II plan. Any universal service charge should be based on a percentage of the overall monthly bill, rather than a flat fee, to ensure that low volume users do not pay a disproportionate share of these costs.

The CALLS III modifications do not eliminate the philosophical or legal infirmities of the CALLS plan, or address the fact that current cost recovery in the Federal jurisdiction is too high.

However, if the Commission designs the cost proceeding properly, they do at least give consumers a fighting chance at a date certain in the future, of preventing further unjustified price increases and create the opportunity to challenge the unfair price increases consumers have experienced since 1996.

The comprehensive consumer settlement offered a post transition structure that would have presumed rates were just and reasonable, while giving petitioners the opportunity to demonstrate that the market is not working and regulated costs dictate a change in prices. The proposed consumer settlement was willing to make that concession because it moved rates much closer to cost (it cut out the excess profits and inefficiencies). CALLS II does not even come close to accomplishing that objective and threatens to move them above costs. Therefore, the FCC must demonstrate that rates are just and reasonable at the expiration of the CALLS plan.

C. KEEPING CALLS I, II, AND III IN CONTEXT

In January of 1996, just before the Telecommunications Act of 1996 was passed, residential consumers paid a Federal charge (called the Subscriber Line Charge) of $3.50 per line to help recover the fixed costs of the telephone network that are used by long distance companies (Interexchange Carriers or IXCs) to provide service. Since the local exchange companies (LECs) incur those network costs, the SLC was paid directly by consumers to the LECs.

Additional costs of the network were paid by IXCs to the LECs in the form of carrier common line charges (CCL). The expression carrier common line charges is appropriate, since it reflect that fact that the telephone line (called a "loop") is used in common by local and long distance services. In essence, the IXCs were paying for the use of the common line in the form

of a carrier common line charge. The IXCs paid these charges to the LECs on the basis of the amount of usage of the network and then recovered these costs in the marketplace (to the extent they could) in the usage charges paid by consumers.

By January 2000, the recovery of costs had been radically changed by a combination of Federal Communications Commission policy and industry pricing practices. The subscriber line charge had been joined by another fixed charge at the bottom of the bill called a Primary Interexchange Carrier Charge (PICC). This charge of $1.50 constituted the first increase in federal fixed charges on the bottom of the bill in over a decade. Moreover, the subscriber line charge, which had been uniform in the residential sector, was sharply increased for residential second lines. Instead of paying $3.50, customers of residential second lines are now charged $6.07. This increase of $2.57 was in addition to the PICC.

As a result of these increases, the average consumer is paying about $2.00 per month more in fixed federal charges. In total, this increase has already cost consumers about $2.50 billion per year.

Over the same period, long distance companies have received about $4 billion in reduced charges that they pay to LECs for the use of the network. Because the FCC has essentially deregulated long distance rates, it could not ensure that these cost reductions were passed through to the public in any systematic way. As a result, IXCs offered discount plans for high volume residential users and negotiated deals with large business users. Thus, the vast majority of consumers suffered a substantial net increase in their bills.

This dramatic increase in fixed charges and cost recovery from low and average volume residential customers took place in spite of the fact that the cost of providing service was declining

dramatically. It took place in spite of the fact that the LECs consistently earned excess profits on the costs they were recovering in the federal jurisdiction.

Against this background of dramatic increases in bills and continuous over-earnings by the LECs, a coalition of the largest local and long distance telephone companies (CALLS) proposed to not only institutionalize these bottom of the bill charges, but to increase them and to increase the total cost recovery in the federal jurisdiction by almost $4 billion. The IXCs went along because they would receive yet another $2 billion reduction in their costs, with no mechanism for ensuring whether, or how, these costs would be passed through to the public.

Consumer groups, small telephone companies, and many state Commissions responded negatively to this proposal, to say the least. Over the past five months, the FCC has sought to reconcile the difference between the CALLS group and consumer groups. No such reconciliation was possible. What has emerged, is the offer of a one-sided truce in a long war with a date certain for resumption of hostilities.

According to the most recent version of the CALLS proposal, hostilities will recommence on July 1, 2001, in the form of a cost proceeding. In the mean time, single line customers will receive a very small, one year reduction in the line items on their bills of approximately $.29. This reduction will be eliminated in the second year and a small increase of $.36 above today's charges will result. At that point, a cost proceeding will be conducted to ascertain whether any further changes (up or down) in fixed cost recovery are justified, with the intention of the LECs to recoup lost revenues through some other mechanism.

This is hardly a great deal for consumers. There is very little near term cost reduction for consumers, with a definite escalation in loop cost recover. Add to that, the LEC's desire to

recover lost revenues and the plan actually places consumers in a worse position than they are today. Additionally, the plan attempts to establish the principle (in contravention of existing case law) that all fixed costs of the network should be recovered directly from consumers, while IXCs get a free ride. This type of cost-shifting and cross-subsidization should be flatly rejected by the Commission.

On the other hand, it is also true that the FCC's earlier decisions that opened the door to the sharp increases in bottom of the bill charges are at least opened for further debate. Things could have gotten much worse if the FCC's misguided decisions adopted soon after the 1996 Act was passed were allowed to run their course. Under the CALLS proposal, there is the possibility that the FCC will apply its concept of forward looking economic costs to the recovery of loop costs in the federal jurisdiction and this could substantially lower the total cost recovery, but only if there are no make whole provisions.

The FCC has also been given a series of promises dealing with costs and pricing policies that are not part of the current proceeding are not enforceable by the FCC. AT&T has agreed to eliminate its minimum usage charges – although these charges never involved costs that the FCC regulated and were not subject to FCC price regulation. AT&T has also promised to change its practice of collecting the universal service charge on a per line basis and begin collecting it as a percentage of the bill. Both of these changes are good for consumers, but in no manner should they be considered a *quid pro quo* for access charge reform. While AT&T claims to link changes in corporate pricing policies that were solely at its discretion to a reduction in its regulated cost of business, these policy changes also reflect negative consumer reaction, Bell Company offers not to charge a monthly fee, and extremely bad publicity. Thus, these "offers" by the some IXCs are

merely the recognition by these entities of practices that are no longer sustainable in a competitive marketplace.

There is no justifiable basis for delaying the appropriate costing and pricing of the loop. The economic analysis already demonstrates that there is an over-recovery of loop costs by the LECs. The Commission has a duty to consumers to ensure that cost recovery is just and reasonable. Perpetuation of a system that results in over-recovery and cost-shifting violates this duty to customers. We urge the Commission to write an Order that allows for fair recovery of loop costs while allowing cost-justified savings to flow through to customers.

D. OUTLINE OF THE COMMENTS

Section II of these comments discusses the analysis of costs in the federal jurisdiction. It argues that forward looking economic costs, which have been the cornerstone of Federal cost analysis since the passage of the Telecommunications Act of 1996, must be applied to access costs, the loop in particular. It demonstrates that all lines, in all zones and all universal service funds must be included in the analysis. To arrive at rates that are just and reasonable, cost recovery must be reduced, if the analysis indicates an over recovery.

Section III demonstrates that forward looking economic costs as estimated by the Commission's Synthesis Proxy Cost Model and the states in their pricing of Unbundled Network Elements are far below the embedded costs claimed by the local exchange companies. This indicates an over recovery of costs, which is reaffirmed by ongoing cost proceedings at the FCC. Consequently, an immediate and permanent reduction in cost recovery is necessary.

Section IV demonstrates that the loop is a cost shared by many services, including long distance. Under the 1996 Act, such costs must be shared among services and basic service can bear no more than a reasonable share of these costs. This is consistent with the case law, which reaches back to 1930 in *Smith v. Illinois*, the practices of the states in cost allocation, and the FCC in a series of decisions since the passage of the 1996 Act. The CALLS proposal contradicts this clear legal requirement by proposing to allow IXCs to use the loop with paying for that use.

Section V reviews other elements of the CALLS proposal which contradict the 1996 and raise concerns. Specific concerns are raised about how companies will meet their obligation to contribute to universal service under section 254 (b) (4) of the Act and how the Commission must ensure that rural and urban rates remain reasonably comparable under section 254 (b)(3) of the Act. It also urges the Commission to write an order that backs up promises to eliminate minimum charges and pass access charge reductions through to consumers with the force of a regulatory requirement.

II. ANALYSIS OF COSTS

A. FORWARD LOOKING ECONOMIC COST MUST BE THE BASIS OF COST RECOVERY IN THE FEDERAL JURISDICTION

In the three and one-half years since the passage of the Telecommunications Act of 1996 the Commission has articulated a paradigm for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Act. Through a long series of orders in the universal service, local competition, and access charge reform dockets the Commission's paradigm has identified the following essential principles (in order of their magnitude of importance measured by their impact on rates or the size of the universal service fund):

- Forward-looking economic costs must be the basis for establishing prices and universal service support[6]
- The loop is a shared cost – shared by all of the services that utilize it.[7]
- Actual competition is the trigger for action, not theory.[8]

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[6] Joint FNPRM

> We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry and innovation, and that a single national cost model will be the most efficient way to estimate forward-looking cost levels (¶ 11).
>
> We adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services (¶ 48).

[7] The most explicit statement can be found at Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service

[8] Joint FNPRM.

With the development of the Synthesis Proxy Cost Model (SPCM) and a Supreme Court ruling upholding the concept of forward-looking economic costs, the end is in sight. Now is the time to implement the above principles.

The FCC has received substantial evidence that rates should be declining because productivity has exceeded the rate of inflation by a substantial margin for the past decade. The most extensive studies of local costs commissioned by Public Counsels across the country show even higher productivity increases than the Commission found in the interstate jurisdiction.[9] The Commission should consider reductions in the SLC and the universal service package, rather than rate increases.

> Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops. To achieve universal service in a competitive market, support should be based on costs that drive market decisions, and those costs are forward-looking costs. (¶ 50)
>
> The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. (¶ 99)
>
> We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to an extent as to threaten universal service. (¶ 105).

[9] "Rebuttal Testimony of Dr. Marvin Kahn, on Behalf of the Office of the Attorney General," Before the State Corporation Commission of Virginia, In the Matter of Evaluating Investigating the Telephone Regulatory Case No. PUC930036 Methods Pursuant to Virginia Code S. 56-235.5, Cause No. PUC930036, March 15, 1994 and "Prefiled Testimony of David Gable on Behalf of the Indiana Office of Utility Consumer Counselor," Before the Indiana Utility Regulatory Commission, In the Matter of Petition of Indiana Bell Telephone Company, Incorporated for the Commission to Decline to Exercise in Part Its Jurisdiction Over Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, to Utilize alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole Its Jurisdiction Over all other Aspects of Petitioner and Its Provision of All Other Telecommunications Service and Equipment, Pursuant to IC 8-1-2.6, Cause Number 39705, January 1994, estimate the productivity offset in the rate of 7 percent per year in the late 1980s and early 1990s.

Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

B. THE MODIFIED COST PROCEEDING

One of the modifications that CALLSII introduced into its proposal was a cost proceeding during the period the caps for the subscriber line charge are increasing. Unfortunately, the proceeding it defined bears no relationship to a legitimate forward looking economic cost proceeding.

The Commission must apply consistent cost principles. UNE rates, high cost support, and federal fixed cost recovery must be calculated using the same principles. CALLSII does not accept this principle. CALLSII reserves the right to litigate the concept of forward looking costs.[10] The Commission must, of course, use the most recent data, for the purposes of that cost proceeding, but the CALLSII proposal, as worded will unleash a firestorm of controversy over

[10] CALLSII, page 8, footnote, 7.

how forward looking costs should be calculated.[11] CALLSII would allow the Local Exchange Carriers (LECs) to use data other than forward looking economic costs. This point has been litigated and decided. The Commission should simply update the existing model, which is solely based on forward looking economic costs.

Treatment of cost zones and second lines is crucial in the cost analysis.. CALLSII handled second lines and cost zones very poorly and this flaw has been recognized in CALLS III.

CALLSII explicitly excluded the consideration of second lines from the cost analysis, which is absurd as an analytic proposition.[12] Because first and second lines share many costs, and the prevalence of second lines is increasing dramatically, it is impossible to properly estimate the costs of primary lines without taking into account the existence of second lines. The CALLSII approach also violates the fundamental principle that charges should be based on costs. The FCC's cost model indicates that the cost of second lines is less than one half that of first lines.

Average SLC must reflect efficient costs and total cost recovery in the federal jurisdiction. As defined by CALLSII, the cost proceeding would preclude the possibility of analyzing cost recovery in zones that are below the cap. The CALLSII proposal would only look at single lines in the highest cost zones. However, costs may have initially been set too high in those areas or they may be declining as second lines are added. Without looking at the cost of all lines, the LECs

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[11] CALLSII, ensures that such a furor will develop by asserting that data, other than that based on forward looking economic costs will be presented to the Commission (CALLSII, p. 8):

> To facilitate this verification, the LEC members of the Coalition commit to provide the Commission with economic data, including data identifying the forward looking costs associated with the provision of retail voice grade access to the public switched network for those areas.

[12] CALLSII Memorandum, p. 8.

are more likely to receive over-recovery of loop costs. CALLS III recognizes this problem.

Universal service funds must be cost justified and properly targeted. CALLS proposes a new $650 million universal service fund, which appears to be immune from cost analysis. The derivation of the $650 million universal service fund is subject to intense dispute. Five of the members of CALLS do not subscribe to the justification of the fund.[13] The sum must be included in any analysis of the total cost recovery in the Federal jurisdiction and it must be scrutinized. A well designed forward looking economic cost proceeding would establish a legitimate basis for this number, but CALLSII does not appear to contemplate the inclusion of such an analysis in the proceeding that commences in July 2001. [14] Other sources of subsidy to fund high cost areas must be included and scrutinized. CALLS III appears to recognize this problem.

Any cost proceeding at the Commission must include the possibility for revenues to decrease as well as increase. CALLSII includes a "make whole provision" that makes a mockery of the cost proceeding.[15] In essence, if the Commission finds on the basis of the forward looking

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[13] CALLSII Memorandum, p. 10, footnote 10.

> Bell Atlantic, BellSouth, GTE, and SBC do not support use of a model to calculate universal service support, and together with Sprint do not join in the citation of AT&T's model-based calculation.

[14] Numerous commentors also point out that the creation of a universal service fund of $650 million to compensate large LECs for so called subsidies embedded in switching charges and the establishment of a floor on access charges has no basis in empirical

[15] Modified Proposal, p. 5.

> In a zone where the Commission has taken such action to change the applicable cap, the difference between the SLC cap that originally would have been applicable and the new SLC cap set by the Commission will not be included in the maximum permitted Average SLC for purposes of section 2.1.6., and that difference will be recovered through the other common line elements. In that event, the Commission should adjust the multiline PICC caps to the extent necessary to mitigate any changes in the CCL rates.